From: salem_update-bounces@lists.oregonstate.edu on behalf of Mills, Jock
To: CAS DeanStaff; CAS Unit Leaders; Salem Update Listserv
Subject: [Salem Update] A pre-forecast update
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In this issue . . . a pre-forecast update

Here's the cliff's note version:

1. The Ways and Means Committee will be taking testimony this week on how to cut budgets in order to manage the current biennium in the face of an additional $300-600 million revenue shortfall. The education hearing is slated for Wednesday, with final decisions expected in early March

2. The next forecast, due to be delivered to a joint session of the legislature on February 20th,will drive budget cuts for the current biennium, and may determine whether lawmakers will dip into scarce reserve funds later this session. The forecast will also guide the Governor and legislators as they craft a budget for the next biennium.

3. As they craft the next biennial budget, legislators are facing a possible $3 billion shortfall. As they set the operating budget for higher ed, legislators will need to balance six moving parts: enrollments, general funds, tuition, financial aid, federal support, and foundation support.

The 2007-09 Biennium

Now that the legislature has passed a state stimulus package, attention has turned to balancing the budget for the remaining five months of the current biennium. Coming up this week are three hearings in the Ways & Means Committee where the public can provide 3-minute snippets of testimony to legislators suggesting where funding can be cut from education, human services, public safety and natural resources budgets. Education reductions will be the topic for Wednesday.

Here is a link to the guidance for testifying.
http://www.leg.state.or.us/comm/lfo/2009_session/public_hearings_notice.pdf

For information about what OSU is doing for this hearing, please contact me.

Based on mid-quarter data, budget writers expect a $300-600 million shortfall for the current biennium, and that number may grow over the next three months when the last quarterly forecast is delivered in May. By then, there will be no time left to make any additional reductions. So reductions need to be identified *post haste*. Legislative cuts will be based on the February 20th forecast, due to be delivered to an

unprecedented joint session on the House floor for all legislators to hear. (Normally the revenue forecast is presented to a joint session of the Revenue Committees.)

In the best case, an additional $300 million reduction could translate to at least a 5 percent reduction in the biennial budgets for most state agencies. If the February forecast shows a greater loss of revenues, legislators will be faced with a decision to either take additional reductions, or to dip into the two reserve funds they have at hand. (There is little or no likelihood they can pass any tax increases to help cover the shortfall for this biennium.) Combined, the two reserve funds hold some $700 million. The Rainy Day fund, established last session when corporate kicker refunds were withheld, cannot be tapped for the current biennium unless the legislature revises the statute that established it. Dipping into it, or the Education Stability Fund, which is fed by contributions from lottery receipts, will require a super majority vote (18 votes in the Senate and 36 votes in the House).

Lawmakers are reluctant to use these funds in the current biennium because doing so will result in fewer dollars being available to balance an abysmal budget for the 2009-11 biennium. Any decision to use these funds will require an assessment of future downside forecasts, the potential for federal stimulus funds to fill in the holes, and whether additional reductions in the current biennium will result in irreparable harm. Given the magnitude of the shortfalls for both the current and future biennia, spending the reserves now is like trying to cushion a falling elevator by jumping up, just before it hits the basement.

Legislators are likely to pass the cuts needed to balance the 2007-09 biennium by early March, giving less than a couple of weeks from the February forecast to determine how to apply reductions across all of the state's services. They want to act quickly to maximize the time agencies have to implement the cuts. Possible reductions are posted on the Ways and Means website:

http://www.leg.state.or.us/comm/lfo/home.htm (Once there, click on "2007-09 Agency 5% Reduction Options".)

What does this mean for higher education? The reductions will largely be drawn from "fund balances" with actual cuts varying from campus to campus. Reductions in fund balances are real cuts. They will result in fewer classes available for students, possibly in the spring, and certainly in subsequent years, since the reserves exist to fill tenured faculty vacancies and to retain instructors. How these reductions will affect OSU will likely be determined in the coming weeks with effects that will not be fully realized until the fall 2009 term.

What about the Federal stimulus package? Federal efforts to funnel money to states to address free-falling state revenues will most certainly help cushion the blow. Nevertheless, the actual provisions have yet to be hammered out between the US House and Senate. (In fact, they have yet to pass the Senate.) It is not clear how much latitude state legislators and governors may have in directing funds to competing human service needs, and among education sectors. In short, the federal stimulus is a moving target and it remains to be determined if any of the federal funds will be available to address shortfalls for the current biennium.

Adding to the uncertainty is whether and how federal funds will apply to state capital spending. For example, with increases in federal research expenditures, federal matching funds may enable new research facilities on college campuses. But if state lawmakers do not have scarce state bonds available to leverage these funds, they may be forced to forego significant opportunities to both create jobs and boost investments in innovative new technologies.

The 2009-11 Biennium

Once the legislature has sought to close the books on the current biennium, it will turn to crafting a budget for the biennium that begins on July 1st. While some legislators have indicated that the harshness of the reductions for the current biennium may make the next one seem less painful, forecasters anticipate a possible $3 billion shortfall out of a $17 billion state budget – an approximate 18 percent reduction.

Clearly the Governor's recommended budget released late last year is obsolete and there is little point in talking about any of the dollar figures it included. While the Ways and Means Co-chairs are expected to issue a legislative budget in late March, it is also possible that the Governor may also issue a rebalanced budget in the coming months. The Governor has indicated that his priorities for meeting the needs of children and education will not be altered by changing economic forecasts, but it is not clear how falling revenues may affect specific programs, or the allocation of funds among competing needs.

Any investments in new programs will be extremely difficult to sustain. Some programs – such as specific elements of the Oregon Innovation Council recommendations, for example – may fall off the table completely.

Six multi-collinear variables in funding Higher Education. Legislative decisions regarding funding for higher education are driven by six basic variables, a number of which are co-related -- as one variable rises or falls, it will drive others to move either up or down. Here is a summary of the key variables legislators will need to address for the next biennium:

1. Enrollment. Unlike K-12 budgets, where education is viewed as compulsory, university budgets are not based on enrollments and enrollment growth. Even though enrollments are expected to increase at both community colleges and universities as the unemployed seek to obtain the necessary skills to compete in a declining job market, it is not clear that additional funding will be wired into the budget to support incoming students.

Unlike K-12, universities can seek to curb enrollments through increased entrance requirements, but such policies are counter to such landmark statutes as the 1862 Morrill Act that created Land Grant universities. Further, any efforts to constrain enrollments will have undesirable effects on students and the legislators who represent them. But if enrollments are left unchecked and unfunded, class sizes will

continue to grow, access to classes will be denied, retention may fall, and the time needed to graduate may increase. An increase in enrollment also increases pressure for general fund appropriations for financial aid under the state's Shared Responsibility Model. (See variable #4 below.)

2. General Funds. The degree to which the legislature appropriates general funds will likely be driven by the macro-economic factors facing the state. While advocacy may help make legislators aware of the needs and can help to secure funding for targeted programs, the bottom line for higher education will ultimately be driven by the overall revenue forecast. In short, what universities get is what we get.

3. Tuition & tuition remissions. When the economy tanked during the 2001-03 biennium, legislators turned to tuition as a source to fill much of the void created by general fund reductions. It is unrealistic to expect a dollar-for-dollar increase in tuition to meet expected shortfalls in general fund appropriations. Nobody wants to see tuition increase beyond projected cost indexes, but the alternatives, such as limiting enrollment, increasing class sizes, and denying access are also unpalatable.

Increases in tuition also will create upward pressure on general fund expenditures for state financial aid. Since the Shared Responsibility Model is based on a calculation of "need", even if enrollments stay the same, an increase in tuition in effect increases both the level of need and the number of students who qualify as "needy."

The impact of tuition increases can be tempered in part through the use of tuition remissions, which in effect, provide scholarships. In previous sessions, the legislature has sought to regulate the degree to which universities use remissions. Remissions may help to address the impact of a tuition increase on low income students, but they also reduce tuition revenues available to fill in the holes created by declining general fund appropriations. Reaching an equitable balance between general fund reductions, tuition increases, and enrollment pressure, is what the politics of state higher education appropriations is all about.

4. Oregon Opportunity Grants/Shared Responsibility Model. The Governor's original recommended budget for the Oregon Opportunity Grant program included a significant increase to meet expected increases in demand, and to reach to students in need. But it is unlikely the planned investments can be sustained under expected revenue projections. The opportunity grant program stimulates demand for higher education. But if the legislature stimulates demand without providing an increase in funding for supply through appropriations to universities, it is providing tickets to ride, but no ride to be had.

5. Federal funds. As previously indicated, state decisions may affect how federal stimulus funds will flow through educational sectors. But they will also affect how significant federal student grants – such as the Pell Grant – and loan funds will flow to students. If the federal government significantly increases Pell grants, but the state does not fund enrollment growth at universities, federal dollars may be left unspent. In those communities that rely on the higher education economy – the trickle down benefits of federal funding efforts will be left unrealized.

6. Foundation funds. For the three larger universities in Oregon (OSU, PSU, and UO), foundations play a significant role in supporting students, faculty, and their infrastructure. Obviously the decline in the stock market has had a serious negative impact on foundation endowments. But the problem is more serious than that. When donors have lined up to support a capital project and the state bond match needed to construct that project goes missing, legislators not only put at risk a specific high priority project for donors, they call to question the ability of any university to raise private philanthropic funds to support Oregon's universities.

Philanthropy at OSU has created the Kelley Engineering Center – which generates more income in research than the monthly mortgage check needed to pay of its bond. Similar results are expected for the Linus Pauling Science Center, soon to be constructed. This session, the OSU Foundation is supporting two buildings, the Hallie Ford Center for the College of Health and Human Sciences, and the Student Success Center to support academic counseling for students across the campus. If the legislature does not fund these projects, it will not only leave donor money on the table, it will frustrate all future efforts to raise private philanthropic contributions for the OSU campus.

Finally the OSU Foundation is instrumental in filling gaps and voids when state funding does not materialize for scholarships. This academic year it bailed out Oregon with funds to support students who were cut off from Oregon Opportunity grants mid stream. But relying on the Foundations to fill in the gaps created by state budget cuts is not a sustainable position.

Where do we go from here?

When we meet with legislators we make three points.

1. We understand that macro-economics, more than advocacy, will ultimately determine what is allocated and taken away from Oregon's universities. That equation must acknowledge how Oregon's universities are our pathway to an economic recovery.

2. There will continue to be uncertainty driven by federal initiatives and the recession. While the legislature may punt some issues to future special sessions, we are governed by an academic year that begins in the fall. We must be able to give students some certainty about what they will pay and what educational services they will receive.

3. We know ultimately that higher education will be given a budget number. If that number also includes strings – such as unfunded mandates that govern courses, course sizes, student behavior, salary restrictions or requirements – we will be left to make irrational decisions. In short: Give us a budget, but do not micro-manage how we reach mutually agreeable results, especially when so many variables are at play.

I will keep you posted as forecasts are issued, cuts are taken, and budget proposals are made.

Questions or concerns, do not hesitate to contact me.

Jock

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Jock Mills
Director, Government Relations
Oregon State University
524 Kerr Administration Building
Corvallis, OR 97330
(541) 737-0725
http://oregonstate.edu/
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